

The Telecommunications Excise Tax is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. See 86 Ill. Adm. Code 495. (This is a GIL).

June 28, 2000

Dear Xxxxx:

This letter is in response to your letter dated March 24, 2000. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department's website at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

Our client (CLIENT), a foreign corporation whose legal and commercial domicile is not located within the state of Illinois, is in the business of providing digital subscriber line ('DSL') services to business and residential customers to access the Internet, and various optional services described below. CLIENT will be providing these services in your state and would like to ensure that it is in compliance with your state's tax requirements. Since these services are part of a newly evolving industry, and in light of the federal moratorium on Internet taxation, we are looking to your agency for guidance by requesting a written ruling from the Department as to the taxation of our client and their services in your state, including all potentially applicable taxes your state imposes such as sales and use, telecommunications, excise and/or other state taxes.

Illinois customers ('Customers') will be able to subscribe to DSL Internet access and other services by signing up with CLIENT under one of three service plans offered. Obtaining DSL services requires that Customers have DSL cable and equipment hooked up to their computers. Since Customers generally have only the computer, CLIENT sells the equipment and cable installation to Customers at separately stated prices.

**Customer Service Plans** Business and residential Customers have the opportunity to subscribe to one of the following three types of service plans:

1. **Month-to-Month:** Customers will be charged by CLIENT for installation and for equipment and will be charged a monthly fee for service after the equipment is installed.

2. One Year: Customers who sign up for one year of service receive free installation of the equipment, but will be charged by CLIENT for equipment. The Customer invoice from CLIENT will actually show a charge for installation, but a promotional credit in the same amount will be on the invoice to offset that charge.

3. Two Years: Customers who sign up for two years of service receive free installation and equipment. The Customer invoice from CLIENT will show a charge for installation and a charge for equipment, but will show a promotional credit in the amount the installation. Customers apply for a rebate equal to the equipment charge directly from CLIENT's underlying service provider. The net effect to the customer is free installation and equipment.

**Equipment and Installation** CLIENT will make a separate charge to Customers for equipment and for installation, but either equipment and/or installation may be offset as described above. CLIENT will not employ any installers nor maintain any inventory in the State.

CLIENT will purchase equipment, cable and installation services from the Carriers from whom it purchases bulk Internet service. Carriers typically charge CLIENT separately for equipment and for installation services which include the necessary cable, but some carriers may provide these to CLIENT for free under the terms of their agreements. Carriers that charge CLIENT for equipment and installation typically credit a promotional allowance to CLIENT's account. This allowance is typically sufficient to offset the equipment and/or cable and installation charges, although it may be identified as an advertising allowance. All Carriers are independent contractor to CLIENT, according to agreements between them; no agency relationships exist.

**Physical Presence** Currently, CLIENT does not maintain personnel or inventory within the State. However, CLIENT may own or lease one or more routers within the State. A router is a piece of equipment needed to provide DSL service to Customers in a given city. Each router is valued at between \$30,000 and \$50,000.

#### **CLIENT's Customer Services**

CLIENT plans to provide to Customers in your state the services described below:

#### **Internet Access & Services**

Internet Access. The base monthly access charge may be \$40 to \$50 for residential customers and \$100 to \$300 for business customers.

Equipment and Installation. These are one-time, optional separate charges, as described above.

Web Hosting. A monthly charge to Customers for additional web page space. This would not be web building, this would merely be providing additional web page space for Customers to build their own sites.

Access to Software. Customers can use applications software while on-line and are charged a usage fee based on length of time used. Software is not down-loadable for stand-alone use.

Access to Games. Customers can access various games while on-line and are charged a usage fee based on length of time used. Game software is not down-loadable for stand-alone use.

Streaming Video. Viewable and down-loadable videos and video clips. Those of an advertising nature are free to viewers, but CLIENT receives a fee from the advertisers. Those of an entertainment nature are accessible by customers for a fee (pay-per-view).

Streaming Audio. Down-loadable music for which a separate charge is made.

### ***Internet Voice Communication Services***

Video Conferencing. Customers would be charged based on length of use for the transmission of voice and images over the Internet between two or more computer sites.

Voice over DSL or IP. Customers would be charged either a per-minute fee or a flat monthly fee for the transmission of two-way voice communication over the Internet from computer to computer or from computer to phone.

### ***Internet Related***

Firewalls. CLIENT would sell Customers hardware and/or software to improve security over the Customer's computer. If only software is sold, it may be down-loaded by the Customer rather than provided in physical form.

### ***CLIENT's Customer Charges***

These other Customer charges may be applied by CLIENT in your state:

Late Payment Fee - If payment is not received by CLIENT within 5 days from the payment due date, the Customer is charged 1.5% per month on the outstanding delinquent balance.

Order Cancellation Fee - Customer may be charged \$250 if she/he terminates service after acceptance but before activation.

Order Processing Fee - a one-time deposit charged on acceptance of a DSL order, fully applied to the Customer's subsequent billings or refunded if service is not available to that Customer.

Reconnection Fee - a charge to reactivate an account that has been disconnected due to non-payment or breach of contract.

Termination Charges - When a Customer terminates service after activation but before the end of the Initial Term, she/he may be charged one amount which is the sum of: (1) the monthly recurring charge for each month remaining under the Initial Term, and (2) an additional termination charge equal to the initial discount, fee waiver or promotional credit previously provided.

Unpaid Check Fee and Rejected Credit Card Fee are charged to Customers in these situations.

#### **Request for Ruling**

Based on the information provided herein, we respectfully request that the Department fully respond to these questions to aid in CLIENT's compliance with the tax laws of your state:

1. On which of the above described Customer Services and Customer Charges will CLIENT be required to collect and remit Illinois sales/use, telecommunications, excise or other taxes? Please provide the statutory authority, regulations, court cases and other interpretations upon which you base your reply. We have attached a matrix for your reply to this question.
2. Will CLIENT's purchases from third-party Carriers of bulk Internet service, Customer equipment, and Customer installation of cable be subject to any Illinois sales/use, telecommunications, excise or other taxes, or would such purchases by CLIENT's be exempt from such taxes? Please provide the statutory authority, regulations, court cases and other interpretations upon which you base your reply.
3. CLIENT could purchase DSL services from in-state carriers without buying or leasing the routers used to provide such services. How would your conclusions to the previous questions change if CLIENT did not own or lease the DSL routers in your state, and otherwise had no physical presence in your state?
4. What effect does Public Law 105-277, the Internet Tax Freedom Act, have on your conclusions? Would your answers be different, but for the existence of the moratorium imposed by that act?

June 28, 2000

If any further information or explanation is needed in order for you to reply to these questions, please contact me at ####. Your prompt reply is greatly appreciated.

The Telecommunications Excise Tax is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. See 86 Ill. Adm. Code 495, enclosed.

Pursuant to Section 495.100(a), "gross charge" means the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by a retailer valued in money, whether paid in money or otherwise, including cash credits, services and property of every kind or nature, and shall be determined without any deduction on account of the cost of such telecommunications, the cost of material used, labor or service cost or any other expense whatsoever.

Generally, persons that provide subscribers access to the Internet and who do not, as part of that service, charge customers for the line or other transmission charges which are used to obtain access to the Internet, are not considered to be telecommunications retailers. See 86 Ill. Adm. Code 495.100(d).

It is our general understanding that most Internet access providers do not, as part of their billing, charge customers for such line charges, but instead, pay to their telecommunications providers all transmission costs that they incur in providing the service. Generally, the customers pay to their providers all transmission costs that they incur while using the service. The single monthly fee charged by such retailers, which often represents a flat charge for a package of items including Internet access, E-mail, and electronic newsletters would generally not be subject to the Telecommunications Excise Tax.

However, please note that persons providing customers with the Internet access described above, but who also provide customers the use of 1-800 service and separately assess customers with per minute charges for the use of such 1-800 numbers, are considered to be telecommunications retailers. Such retailers will incur Telecommunications Excise Tax on charges made for such 1-800 services. If, however, such Internet service providers do not separately assess customers with per minute charges, but pay their own providers for all transmission costs for the 1-800 service, they are not considered telecommunications retailers.

We are unable to determine from the information in your letter whether you are a telecommunications retailer.

In regards to monthly service charges, please note that the term "gross charges" is defined at 35 ILCS 630/2(a), and includes the amount paid for the act or privilege of originating or receiving telecommunication in Illinois and for all services and equipment provided in connection therewith by a retailer. See the enclosed copy of 86 Ill. Adm. Code 495.100. Access charges and monthly service fees are generally fully included in gross charges subject to the

Telecommunications Excise Tax. Customer equipment and labor charges are also included in gross charges subject to tax.

Effective January 1, 1998, the Telecommunications Municipal Infrastructure Maintenance Fee Act (Act) (35 ILCS 635/1 et seq.) provides for the imposition of various fees upon telecommunications retailers. Section 15 of the Act imposes a State infrastructure maintenance fee upon telecommunications retailers, as that term is defined in 35 ILCS 635/10, "equal to 0.5% of all gross charges charged by the telecommunications retailer to service addresses in this State for telecommunications, other than wireless telecommunications, originating or received in this State." (35 ILCS 635/15(b).)

Section 15 also provides for an optional infrastructure maintenance fee which telecommunications retailers may pay "with respect to the gross charges charged by the telecommunications retailer to service addresses in a particular municipality for telecommunications, other than wireless telecommunications, originating or received in the municipality...." (35 ILCS 635/15(c).) These fees are collected, enforced and administered by the Illinois Department of Revenue. (35 ILCS 635/25(b).)

Section 20 of the Act provides that municipalities may impose a municipal infrastructure maintenance fee upon telecommunications retailers. This fee is based upon gross charges charged by the telecommunications retailers to service addresses in the municipality for telecommunications originating or received in the municipality. This fee is collected, enforced, and administered by the municipality imposing the fee. (35 ILCS 635/25(c).)

Illinois municipalities are also authorized to impose a municipal telecommunications tax. (See 65 ILCS 5/8-11-17.) The tax is imposed on the act or privilege of originating in such municipality or receiving in such municipality intrastate or interstate telecommunications by a person at a rate not to exceed 5% of the gross charges for such telecommunications purchased at retail by such person. (See 65 ILCS 5/8-11-17(a)(1) and 65 ILCS 5/8-11-17(a)(2).) This tax may only be imposed if the municipality does not have in effect an occupation tax imposed on persons engaged in the business of transmitting messages by means of electricity as authorized by Section 8-11-2 (65 ILCS 5/8-11-2) of the Illinois Municipal Code. The municipality imposing the tax provides for its administration and enforcement, not the Illinois Department of Revenue. Therefore, questions regarding this tax should be addressed to the individual municipalities imposing it. There is no equivalent statute for county governments.

In addition, the Emergency Telephone System Act provides that "[t]he corporate authorities of any municipality or any county may, subject to the limitations of subsections (c), (d), and (h), and in addition to any tax levied pursuant to Section 8-11-2 of the Illinois Municipal Code, impose a monthly surcharge on billed subscribers of network connection provided by telecommunication carriers engaged in the business of transmitting messages by means of electricity originating within the corporate limits of the municipality or county imposing the surcharge at a rate per network connection determined in

accordance with subsection (c)." (See 50 ILCS 750/15.3(a) and (c).) "The surcharge authorized by this Section shall be collected from the subscriber by the telecommunications carrier providing the subscriber the network connection as a separately stated item on the subscriber's bill." (50 ILCS 750/15.3(f).) This surcharge is paid to the municipality, county or Joint Emergency Telephone System Board. (See 50 ILCS 750/15.3(g).) Questions regarding the surcharge should be addressed to the municipality or county imposing it.

Sales of "canned" computer software are taxable retail sales in Illinois whether purchased off the shelf or downloaded over the Internet. See the enclosed copy of 86 Ill. Adm. Code 130.1935. Section 2-25 of the Retailers' Occupation Tax Act defines "computer software" as "a set of statements, data or instructions to be used directly or indirectly in a computer in order to bring about a certain result in any form in which those statements, data, or instructions may be embodied, transmitted, or fixed, by any method now known or hereafter developed ..." Consequently, sales of music which are downloaded over the computer are subject to tax as sales of computer software. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c). In determining whether software is "canned" or is "custom," please note that custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3). Licenses of computer software, whether canned or custom, that meet all of the criteria provided in Section 130.1935(a)(1), will not be subject to Retailers' Occupation Tax nor will the transfer of the subsequent software updates related to that software.

When you give items of tangible personal property as a gift, you will owe Use Tax in Illinois if the gift occurred in Illinois. Retailers incur Retailers' Occupation Tax on their gross receipts from retail sales. Gross receipts are defined as all the consideration actually received by a seller from whatever source, except traded-in tangible personal property. See the enclosed copy of 86 Ill. Adm. Code 130.401. If sellers receive a reimbursement or rebate from any other source, the amount of that reimbursement or rebate is considered part of the gross receipts received by those sellers and is fully taxable. If retailers offer discounted prices for items and do not receive any reimbursement or rebate for those discounts, the lower amounts received for those items would be the retailers' gross receipts for those sales. The retailers would incur Retailers' Occupation Tax on those lower amounts and the purchasers would pay the corresponding Use Tax to the retailers based upon those same amounts. See the enclosed copies of 86 Ill. Adm. Code 130.420, Discounts, and 130.2125, Trading Stamps and Discount Coupons. If a discount reduces the selling price to zero, Use Tax will be owed by the retailer if nexus exists or by the purchaser if the retailer does not have nexus with Illinois.

The following information outlines the principles of nexus. An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory.

The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers. You have indicated in your letter that your client "does not store inventory, occupy offices, have a server, or staff employees within" Illinois. If your client does not accept purchase orders in Illinois or maintain an inventory in Illinois and fill Illinois orders from that inventory, your client is not an Illinois retailer.

A "retailer maintaining a place of business in Illinois," as defined in 86 Ill. Adm. Code 150.201(i), enclosed, is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, enclosed. The Retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability. Determining whether a retailer is maintaining a place of business in Illinois is extremely fact specific. The Department cannot make such a complex ruling with the type of limited information that is provided in requests for General Information Letters or Private Letter Rulings.

The United States Supreme Court in Quill Corp. v. North Dakota, 112 S.Ct 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Cause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. Quill at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to Brown's Furniture, Inc. v. Zehnder, (1996), 171 Ill.2d 410.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State. The Use Tax rate is 6.25%.

The purchase of equipment that you lease to customers may be subject to Use Tax. Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.



A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

If you make retail sales of equipment in Illinois, you will be responsible for Retailers' Occupation Tax. Please see 86 Ill. Adm. Code 130.101 and 130.2010.

It is unclear from your letter which entity is installing the cable. Please note that the installation of cable may be considered a construction contractor situation. Please find enclosed copies of 86 Ill. Adm. Code 130.1940 and 130.2075 regarding the tax liabilities of contractors in Illinois. The term "construction contractors" includes general contractors, subcontractors, and specialized contractors such as landscape contractors. The term "contractor" means any person or persons who are engaged in the occupation of entering into and performing construction contracts for owners. In Illinois, construction contractors are deemed end users of tangible personal property purchased for incorporation into real property. See Section 130.1940. As end users of such tangible personal property, contractors incur Use Tax liability for such purchases based upon the cost price of the tangible personal property. Therefore, any tangible personal property that general contractors or subcontractors purchase that will be permanently affixed to or incorporated into real property in this State will be subject to Use Tax. If contractors did not pay the Use Tax liability to their suppliers, they must self-assess their Use Tax liability and pay it directly to the Department.

The Internet Tax Freedom Act does not affect the imposition of the above taxes because of the provision in that Act that exempts state laws already in effect on the date that the Internet Tax Freedom Act became effective.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further

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questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis  
Associate Counsel

MAJ:msk

Enc.